No. 22788

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22788

WHITE CHEMICAL COMPANY, Appellant,

v.

HENRY MORADIAN, RECEIVER in Bankruptcy of CAL-ZONA FARMS, a Corporation, and Henry Moradian, Trustee in Bankruptcy, et al, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

REPLY BRIEF OF APPELLANT

McKESSON, RENAUD, COOK, MILLER & CORDOVA

31 Luhrs Arcade
Phoenix, Arizona 85003

Attorneys for Appellant

No. 22788

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22788

WHITE CHEMICAL COMPANY, Appellant,

v.

HENRY MORADIAN, RECEIVER in Bankruptcy of CAL-ZONA FARMS, a Corporation, and Henry Moradian, Trustee in Bankruptcy, et al, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

REPLY BRIEF OF APPELLANT

McKESSON, RENAUD, COOK, MILLER & CORDOVA

31 Luhrs Arcade
Phoenix, Arizona 85003

Attorneys for Appellant

I N D E X

TABLE OF AUTHORITIES CITED

Cases

Statutes

TABLE OF AUTHORITIES CITED

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22788

REPLY BRIEF OF APPELLANT

SUMMARY OF ARGUMENT

It is respectfully submitted to the Court that the Certificates of Indebtedness issued to SOUTHWEST FOREST INDUSTRIES, INC. (hereinafter referred to as SOUTHWEST), and to PRODUCERS COTTON OIL COMPANY (hereinafter referred to as PRODUCERS), are costs of administration in the superseded Chapter XI Bankruptcy Proceedings and as such are entitled to no priority over other costs of administration in the superseded Chapter XI proceedings. The Appellant, WHITE CHEMICAL COMPANY (hereinafter referred to as WHITE), furnished goods and services to the debtor corporation, as set forth in the Transcript of Record at pages 143 and 144, which had a reasonable value of twenty-eight thousand four hundred fifty-one and 28/100 ($28,451.28) dollars. This amount was allowed as a cost of administration of the superseded Chapter XI proceedings (Transcript of Record, page 147).

It is further submitted to the Court that the Bankruptcy Court has no power, authority or jurisdiction to exercise equitable powers which have the effect of circumventing the enactments of Congress, as such enactments have been set forth in the Bankruptcy Act and, in particular, in § 344 (11 U.S.C. § 744) and in § 64(a)1 of the Bankruptcy Act [11 U.S.C. § 104(a)1].

It is submitted that under § 344 (11 U.S.C. § 744), the authority of the Court is restricted to granting unto Certificate holders security and priority over "*existing obligations*" and not over other costs of administration.

It is further submitted that under § 64(a)1 of the Bankruptcy Act [11 U.S.C. § 104(a)1], all costs of administration which have been incurred and are unpaid are on a parity and should share on a pro rata basis in the assets available after the payment of the costs of administration of the superseding bankruptcy proceeding.

STATEMENT OF FACTS

It is submitted that the facts that are pertinent and controlling upon the decision in this case are as they have been set out in the prior briefs of appellant and appellees and as set forth in the portions of the Transcript of Record

which have been referred to by both appellant and appellees in prior briefs and herein.

ARGUMENT

It is respectfully submitted to the Court that two sections of the Bankruptcy Act control the case at bar. It is further submitted that these statutes are concise and contain no ambiguities.

It is further submitted that these two statutes should be followed, as they have been enacted by Congress and that when this is done the appellant will then be found to be entitled to share equally with appellees in the funds available for the payment of the costs of administration of the superseded Chapter XI proceedings.

Appellees have cited two cases in addition to the ones cited to the Court in Appellant's Opening Brief. On page 15 of Appellee's Brief, the case *In re Miracle Mart, Inc.* (3rd [sic] Cir. June 3, 1968), C.C.H. Bankruptcy Reports ¶ 62,784 at p. 72,388 is cited. At p. 72,390 of the C.C.H. Report the Second Circuit noted:

> "Instead, we have a series of inconsistent sections which create a fundamental ambiguity. We are required, therefore, to construe the Bankruptcy Act as best we

> can. *We believe that in such circumstances resort to the equitable powers of a bankruptcy court to fashion a remedy for this aberrant situation is justified.*" (Emphasis added)

It is submitted that in the case at bar, we do not have any inconsistent sections, and it is submitted further that throughout the course of this litigation the appellees, before the Referee, the District Court, and now before this Court, consistently and constantly disregard, overlook and hope that the words of the statute, that it is submitted are controlling, will fade away. These words are "*existing obligations*" as set forth in § 344 (11 U.S.C. § 744).

COLLIER ON BANKRUPTCY, Vol. 8 (14th ed. 1967), at pp. 1004, 1005 and 1006, treats this language relating to existing obligations. In ¶ 7.1 of § 6.40 at p. 1005 of COLLIER ON BANKRUPTCY, as above cited, this learned treatise states that the Certificates may be made superior to costs of administration and cites as its authority *Todd v. Zoda* (C.A.2d, 1951) 188 F.2d 84, and *In re Delaware Hosiery Mills* (C.A.3d, 1953) 202 F.2d 951. In the case of *Todd v. Zoda, supra,* the Second Circuit stated at p. 86 of the opinion:

> "This Court has recognized that in exceptional instances equitable considerations may justify a court of bankruptcy in validating an unauthorized loan as an expense of administration. None of these cases involved the question whether equitable considerations would justify a loan-claimant in obtaining priority in payment over prior lenders to the debtor in possession or over subsequent expenses of administration advanced by creditors who had no notice of the loan-claimant's claim to priority."

As pointed out in Appellant's Opening Brief, *In re Delaware Hosiery Mills, supra,* has a footnote numbered 6 on p. 953 of the Report, which states:

> ". . . research has not disclosed any case where there was a provision that the certificate or loan had priority over expenses of administration."

Appellees state "the granting of such priority to Receiver's Certificates is authorized by Section 344" (Appellees' Brief, p. 1). On p. 15 of Appellees' Brief, they state:

> ". . . however, even if the priority treatment accorded the Receiver's Certificates was not expressly authorized by statute, it would be within the equitable powers of the Bankruptcy Court to accord such priority."

This is the language that *In re Miracle Mart, Inc., supra,* is cited in support of. It must be remembered that in the *Miracle Mart* case the Court specifically found a series of

inconsistent sections which were subsequently cured by amendment to the Bankruptcy Statutes as noted in that case.

It is respectfully submitted that § 344 of the Bankruptcy Act (11 U.S.C. § 744) does not under any stretch of the imagination nor under any judicial construction known to the appellant authorize the granting of priority to a Certificate holder over another cost of administration. The plain, clear, concise and unambiguous language states that the Certificate may be given priority *over existing obligations*. It is submitted that if Congress had intended the Certificate holder to have priority over other costs of administration, Congress would then in its infinite wisdom have stated "over existing obligations and other costs of administration."

The appellees cite a case out of this Circuit, *In re Bridgford Co.* (C.A. 9th, 1956) 237 F.2d 182. In that case at p. 186, this Court stated:

> "There is no need to consider the priority status of the claims of the Oregon farmers nor the status of the certificates had they been retained by Hadley for, as we have pointed out, Bridgford is precluded from collecting more than he paid for a claim against an insolvent corporation to which he owed a fiduciary duty."

It is submitted that based upon that language the

statement on p. 13 of Appellees' Brief is incorrect where appellees state that this Court recognized inferentially that Receiver's Certificates may provide for and be accorded priority over other expenses of administration. It is submitted that the ratio decidendi of that case was that a fiduciary could not profit from a transaction as against the person to whom a duty was owed and in particular when there was no consideration flowing in the acquisition of the claim.

It is respectfully submitted to the Court that the case at bar is novel. The appellant has been unable to find a Court decision in the entire United States that has ruled upon the problem in the case at bar. In the case of *In re Columbia Ribbon Co.*(C.A.3d, 1941) 117 F.2d 999, the ratio decidendi of the decision was the parity or priority between costs of administration of a chapter proceeding and a superseding bankruptcy. This case was decided prior to the amendment which accords priority to the costs of administration of a bankruptcy proceeding that supersedes a chapter proceeding. In the *Columbia Ribbon* case, the Court stated at p. 1001:

> ". . . since Congress has set up no order of priority within the first class the Court may not fix priorities within the class."

Since that time, Congress has established one subpriority. *It does not relate to Receiver's Certificates.*

It is respectfully submitted that no authority has been cited to hold that loans to a receiver are not costs of administration. Notwithstanding the degradation to which a dissenting opinion was subjected by the appellees, in the case of *In the Matter of A. M. Townson & Co., Bankrupt* (C.A.3d, 1960) 283 F.2d 449, appellant still feels that the language from that dissent is a correct statement of the law where it is stated, as cited in Appellant's Opening Brief, on p. 17:

> ". . . court-authorized loans made to receivers to finance their operations are in the category of 'the actual and necessary costs and expenses of preserving the estate' and are accorded first priority as an 'expense of administration.'"

In re Columbia Ribbon Co., supra, states at p. 1001:

> "It follows that the court in determining the priority of claims against the estate is bound by the provisions of Section 64 sub. a, as amended, 11 U.S.C.A. § 104 sub. a, which specify the classes of debts which are to have priority of payment over general creditors of a bankrupt estate and the order of their payment with respect to each other."

This language in light of *Nicholas v. United States,* 86 Sup. Ct. 1674, 384 U.S. 562, would seem to indicate

that the equitable power of the Bankruptcy Court is limited since Congress has superseded such equitable power with its statutory enactments. At p. 1683 of the Supreme Court Report, it is stated:

> ". . . the strong policy of § 64 a (1) of the Bankruptcy Act, . . . establishes a sharply defined priority that places all expenses of administration on a parity, ..."

It is true that in the *Nicholas* case, tax problems were being litigated, but it is respectfully submitted that the Supreme Court has indicated that the priorities established by § 64(a) of the Bankruptcy Act are sharply defined and that under § 64(a)1 all expenses of administration, including claims for taxes which were a cost of administration, in that case, are on a parity.

It is therefore respectfully submitted to this Court, that since the funds derived through the vehicle of the Certificates of Indebtedness are properly classified as a cost of administration, *In the Matter of A. M. Townson & Co., supra,* the fact that that cost of administration is evidenced by a Certificate of Indebtedness should not give to it priority over other costs of administration, even though the Certificate provides for such priority. It is this provision of priority in the Certificate that the

appellant has constantly challenged throughout the course of these proceedings.

In the case of *In re Concentrated Products Corp.* (C.A.3d, 1930) 38 F.2d 745, the Court stated at p. 747:

> "But, despite the equitable nature of much of the bankruptcy court's undertakings and procedure, the fact remains that there is a wealth of statutory enactment which places definite limits on the court's action, and which the court has no right to vary."

The Court at p. 747 cited the following language from *In re Judith Gap Commercial Co.*, 5 F.2d 307 at 309:

> ". . . *Nor is it inconsistent with the established doctrine that always is jurisdiction in bankruptcy limited by statute, and that though bankruptcy proceedings are equitable in their nature and must be carried on as such, nevertheless they are to be administered in accord with the Bankruptcy Act and general orders, and not by virtue of any broad unlimited equity power.* [Citations omitted]."
> (Emphasis added)

It is further submitted to the Court that the appellant fully and completely recognizes the equitable power of the Bankruptcy Court. However, the appellant respectfully submits to the Court that in this case statutory enactment has placed definite limits on the Court's equitable power, including the prohibition against granting

one cost of administration priority over another cost of administration.

The appellees have distinguished appellant's cases and it is true that none of them deal directly with what it is submitted is in issue in this case. It is simply the best we could do, because, as stated hereinbefore, the appellant has been unable to find any case which is right in the "rumble seat."

In conclusion, it is respectfully submitted that the Bankruptcy Court, under § 344 (11 U.S.C. § 744) had authority to authorize the borrowing of money and issuing of Certificates of Indebtedness evidencing such loans but the Bankruptcy Court was limited in that it could only grant to the lender and Certificate holder, the appellees herein, security and priority *over existing obligations.* Under the *Nicholas v. United States* case, *supra,* the sharply defined priorities established by § 64(a) of the Bankruptcy Act, deprive the Court of equitable power to vary these priorities as they have been established by Congress.

In re Concentrated Products Corp., supra, it is submitted, lays down the principle that the equitable powers of the Bankruptcy Court must always give way and are limited to the extent that Congress has enacted specific

statutes relating to the subject matter in issue. *In re Delaware Hosiery Mills, supra,* in the footnote states that no case can be found as of that date and none have been found by the appellant, wherein debts evidenced by Certificates of Indebtedness issued pursuant to § 344 (11 U.S.C. § 744) were given priority over other costs of administration.

In re Columbia Ribbon Co., supra, states on p. 1002:

> ". . . . The Court may not by granting a priority which it deems equitable set aside the clear congressional mandate that no such priority shall be accorded. . . ."

It further stated:

> ". . . . But these equitable powers are to be exercised within the limits laid down by the Bankruptcy Act and subject to its specific provisions. . . ."

It is further submitted that the Bankruptcy Act must be considered as a whole and it is submitted that Congress in its wisdom was aware of a difference between "existing obligations" as stated in § 344 (11 U.S.C. § 744) and costs of administration as stated in § 64(a)1. That by reason of such congressional wisdom, it is submitted that if Congress had intended that Certificates of Indebtedness have priority over other costs of administration, it very

easily could have stated "over existing obligations and other costs of administration." *This Congress did not do.*

The appellant quarrels not with the equitable power of the Bankruptcy Court. Appellant takes the position and respectfully submits to this Court that the equitable power of the Bankruptcy Court has been superseded by congressional enactment.

The appellant further submits to this Court that the claims of the appellees represented by the Certificates of Indebtedness are costs of administration. The provisions contained in such Certificates, according unto the holder thereof a priority over other costs of administration, are provisions that have been allowed by the Bankruptcy Court in excess of its authority to grant the same. The clear intent of Congress, it is submitted, is spelled out in the two applicable statutes. This statutory language authorizes the Bankruptcy Court to authorize Certificates of Indebtedness and to accord to such Certificates priority *over other existing obligations*. The holder of such Certificate, it is submitted, is merely another claimant for a cost of administration expense.

Based upon the foregoing, the Opening Brief of the Appellant herein, and the failure of appellees to show

authorities to the contrary, it is respectfully submitted that this case should be remanded to the District Court under a mandate requiring the District Court sitting as a Court of Bankruptcy to distribute all funds and assets available after the costs of the superseding bankruptcy to the claimants for the cost of administration in the superseded bankruptcy on a pro rata basis including the appellant herein.

Respectfully submitted,

McKESSON, RENAUD, COOK, MILLER
& CORDOVA

/s/ Joseph B. Miller
By _____
Joseph B. Miller

31 Luhrs Arcade
Phoenix, Arizona 85003

Attorneys for Appellant

AFFIDAVIT OF SERVICE BY MAIL

JOSEPH B. MILLER, being duly sworn, says that he deposited two (2) copies of the foregoing Reply Brief of Appellant in final printed form in the United States Post Office in the City of Phoenix, State of Arizona, enclosed in envelopes duly addressed as follows:

Richard B. Wilks, Esq.
1220 Arizona Title Building
Phoenix, Arizona 85003

Attorney for Receiver-Trustee, Appellee

Rawlins, Ellis, Burrus & Kiewit
William D. Baker, Esq.
733 Security Building
Phoenix, Arizona 85004

Attorneys for Producers Cotton Oil Co.

Fennemore, Craig, von Ammon, McClennen
& Udall
Robert H. Carlyn, Esq.
900 First National Bank Building
Phoenix, Arizona 85004

Attorneys for Southwest Forest Industries

James B. Rolle, III, Esq.
10th Floor, 111 W. Monroe
Phoenix, Arizona 85003

Attorney for Debtor

Postage on the foregoing mailings was fully prepaid; he further states that he deposited twenty-five (25) copies in the United States Post Office in the City of Phoenix, State of Arizona, duly addressed to the Office of the Clerk, U. S. Court of Appeals for the Ninth Circuit, San Francisco, California 94101.

All mailings were made on the 1st day of August, 1968.

/s/ Joseph B. Miller

Joseph B. Miller

Subscribed and sworn to before me
this 1st day of August, 1968.

/s/ Catherine F. Howard

Notary Public [SEAL]

My commission expires
September 29, 1971